

Micro credit and microfinance are being developed as strategies for infrastructure development, poverty alleviation and income generation. This fact sheet provides a brief overview of microfinance for sanitation.

The success of the microfinance approach in supporting informal micro-enterprises in poor countries has led to it being considered in other areas of development. For example, the use of microfinance intermediaries to supply the credit needed to implement water and sanitation services

shared sets of latrine units. Repayment was to be made by the landlord over a 2-3 year period to recover their costs. The landlord would either add an amount to the rent or collect a separate fee.

Collection of loan payments in this way has proved problematic. It has led to over billing of tenants and lapses to the regular payment schedule. Landlords sometimes retained funds until all tenants had paid up or used the money as working capital.

As of May 1993, over 40 per cent of the 224 loans disbursed in the 3 pilot areas were in arrears. Collection was further complicated by the fact that the responsibility for debt collection did not lie with a single financial institution but rather a combination of project staff and the community steering committee which added to overall loan administration costs.

The Co-operative Housing Foundation (CHF) programme is a national strategy to provide loans for housing improvements in Tegucigalpa, the capital of Honduras. As of 1993, the program had disbursed around US\$4 million dollars to Honduran NGOs for on-lending to some 4000 households. Sanitation was identified as a niche in this market and a UNICEF grant of US\$350,000 was provided to establish a revolving fund for sanitation improvements.

The goal of the CHF programme was to develop NGO capacity to develop their own credit lines from other government departments and eventually the private banking sector. This meant that they first had to establish a track record of making and recovering loans successfully.

Loan agreements were made by beneficiaries directly with the NGO. No collateral was required although the backgrounds of borrowers were closely investigated. Co-signers were used to guarantee payments. Typically the loan would have a duration of 3 years and be paid off in monthly instalments. The average rate of interest was 15% which was low compared with alternative sources of informal finance through money lenders or retail credit.

The NGO's achieved a very high recovery rate of 95% in the early years. Some even developed alternative credit lines as planned. The prospects for integration with the formal sector seem very encouraging.

The success of this scheme can be related to the wide range of options in terms of the type of improvement made, the loan term and the quality of the improvement offered by lenders. Borrowers could tailor their lending package to their individual needs and hence the initiative avoided the 'one size fits all' approach. It was discovered that households were often prepared to choose the high cost option if the incremental increase in property value was considered to be high.

The flexibility of loan terms meant that borrowers and lenders could test the loan system at lower risk to each party. Smaller shorter term loans for sanitation were sometimes paid off early to be replaced by larger longer term agreements for more substantial housing improvements.

Provision of reliable technical advice and help in negotiating construction contracts was a key factor in attracting borrowers with plans to upgrade their sanitation facilities. Low income households often did not have the information necessary to make an informed decision about sanitation provision. A prime function of the loan officer was to monitor construction quality for the customer and use this ability to refuse disbursement to keep contractors in line.

A large subsidy is built into the loan programme i.e. the technical support provided by the CHF, but there is also provision in the financial planning for CHF to get sufficiently close-to-market interest rates from NGOs to preserve the value of the fund's asset base. When the NGO's take over the CHF function, the cost of expert staff will be much lower increasing the potential for sustainability (Co-operative Housing Foundation, 1993)

Sanitation interventions have had relatively low impact considering the scale of the problem i.e. 2.4 billion people without access to adequate sanitation. Very few programmes have reached more than 100,000 people. And even when latrines have been constructed, many are not used or not used

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In Ghana, 22 Water Boards have formed the Association of Water and Sanitation Development Boards (AWSDB), which have a similar strategy as the community group revolving funds, but at a different scale.

A key strategy of the AWSDBs to mobilise deposits was to establish a pooled reserve fund, which is invested in Treasury Bills and other short-term, low risk, high return investments. The interest earned on the reserve fund represents a large capital base for member boards in each district for their water supply and sanitation activities.

Microfinance and commercial project development can be linked with subsidised activities (mainly done by NGOs) such as sanitation promotion and other technical support for cost-effective solutions and quality control (for instance care with contamination of water sources).

Given the need to build new markets and expand a client base, some MFIs have sought strategic alliances with NGOs and other financial intermediaries. These offer the possibility of complementary skills to reach these markets, with lower running costs for the MFIs since these are supported by the financial intermediaries.

WPI focuses on Strategic Partnerships to help bridge the MFIs and the traditional water sector NGOs. WPI provides financial support to MFIs to conduct pilot projects in the water sector and partners with them to equip them with expertise in the sector. WPI also provides NGOs with operations and credit training (by teaming them up with leading MFI banks in their region) in order for them to launch and manage microfinance operations.

The sanitation microfinance pilot projects with the NGOs in Tamil Nadu in India have reached

mechanisms used as in this way a sustainable financial system is achieved. Instead of subsidizing directly household sanitation, aid can be used to cover some of these costs.

Loan administration and collection system need to be simple and adapted to the specific needs of the client.

